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Prospects Brighten for State and Local Aid from Washington.

With Democrats in control of the Senate and the rest of Washington, further stimulus is a near-certainty. State and local aid, which has been held up by the GOP, will be part of the mix.

Washington is suddenly looking more generous. Last Tuesday's elections in Georgia gave Democrats control of the Senate. That means, among other things, there's new hope that Congress will provide additional aid to states and localities.

"There will be another bill," says Patrick Murphy, vice president of public finance at Arnold Ventures, a philanthropic foundation. "I don't question that now."

What an aid package will look like, however, is anyone's guess. Over the past year, congressional Republicans and Democrats have remained far apart on the issue. Back in May, House Democrats passed the Heroes Act, a COVID relief package that included \$1 trillion for state and local governments. Senate Majority Leader Mitch McConnell balked, at one point suggesting that states having problems should declare bankruptcy.

But McConnell will no longer be running the Senate. That means the prospects for additional aid, which were starting to look like a dead issue, have suddenly brightened. Once Kamala Harris is sworn in as vice president, she will provide the tie-breaking vote in a chamber that will be split 50-50 after the Georgia results are certified (which will happen no later than Jan. 22).

"There are very basic things that states need to survive right now that are possible tonight that were not possible this morning," Anne Caprara, chief of staff to Illinois Gov. J.B. Pritzker, tweeted in response to the Georgia Senate results. "These races really were that consequential."

Struggling states, cities and counties shouldn't count on an enormous windfall. The fact that the stock market has held up and the economy has recovered more rapidly than anticipated in the spring means that the revenue picture is now better than anticipated. "It's not just that some states are doing better than they expected based on forecasts there were developed at the darkest point economically," says Tracy Gordon, a senior fellow with the Urban-Brookings Tax Policy Center. "Some states are doing better than they were the previous year."

That's a minority of states, Gordon points out. And, even though revenues aren't as bleak as they once appeared, expenses continue to mount, given demands on unemployment, health and other social service programs.

In December, state and local governments shed 52,000 jobs, bringing the total number they've lost since the pandemic to nearly 1.4 million - almost double the amount following the Great Recession.

"Even though revenues might look a little bit better, that doesn't account for the unbudgeted expenditures that cities are making, such as buying personal protective equipment and paying for

people to make sure restaurants are in compliance,” says Michael Wallace, a legislative director for the National League of Cities. “Funding for existing priorities got shifted into things like that.”

But a fiscal picture that is muddy rather than drastic has dampened congressional interest in making states and localities a priority. Economists generally agree that aid to lower levels of government is among the best ways to boost the economy during a recession, having a multiplier effect on economic activity, but members of Congress are always reluctant to raise revenues and then let someone else spend it. That’s a bipartisan reality.

Democrats will hold the Senate by the narrowest possible margin. It’s likely that they’ll have to give in to some Republican demands, assuming aid is passed as part of normal legislation that would need 60 votes to break a filibuster. “Yes, the Democrats have the Senate now, but it’s the slimmest of slim margins,” Murphy says, “and that means that compromises have to be made.”

Still, anything is better than nothing, which might have been the continuing story if Republicans had held onto the Senate.

“It’s been made pretty clear that Senate Democrats in particular are looking at ways to include state and local government aid in the next (relief) bill,” says Dan White, director of fiscal policy research with Moody’s Analytics, a financial research firm. “There are a lot of blue-state senators whose states are being badly hurt.”

Don’t Spend It All in One Place

Last month, McConnell made clear his opposition to handing governors a blank check. Particularly Democratic governors. “Democrats are acting like it’s more important to supply the governor of California with a special slush fund than to help restaurant workers in California keep their jobs,” he said last month during floor debate over the most recent stimulus bill.

McConnell is not alone in holding that kind of attitude. Xavier Becerra is Joe Biden’s pick for Health and Human Services secretary. The last time a Democratic administration took power, back in 2009, he was vice chair of the House Democratic Caucus. He warned Obama administration officials against direct aid to states. “A lot of us were saying, don’t give the governors slush funds,” Becerra said, according to Michael Grunwald’s book about the 2009 stimulus package, *The New New Deal*.

Becerra will no doubt be on board this time around. Biden wants to see additional aid to states and localities.

Perhaps as important, Joe Manchin supports the idea. Manchin is considered the most conservative Democratic senator, so his vote will be the chamber’s tipping point. Manchin, a former West Virginia governor, cosponsored multiple attempts to provide aid to states and localities last year, including initial provisions in the stimulus package enacted last month.

Although that package did not end up including direct aid, it did provide substantial money for state and local functions. Notably, it provides \$82 billion for K-12 and higher education, as well as \$20 billion for states to fund vaccine distribution.

That’s \$100 billion states won’t have to spend on those programs. “Money’s fungible,” Murphy says. “That’s money they can use for something else.”

In addition, states and localities will benefit from additional dollars provided by the package in areas such as unemployment, small business loans, rental assistance and stimulus checks. They aren’t receiving that money directly, but it will all lead to more spending and other activity that can be

taxed.

How Much Do They Need?

The trillion-dollar figure in the Heroes Act didn't appear out of thin air. Last spring, there were various estimates that showed states, cities and counties were collectively looking at shortfalls of that magnitude over a three-year period.

The combination of earlier rounds of federal stimulus, the fast-recovering stock market and the fact that the pandemic's economic effects have fallen hardest on low-income workers has kept revenues from declining as steeply as initially expected.

"The economy is performing much better than people thought," Gordon says. "In July, the Congressional Budget Office forecast that personal income would be down 6 percent in the third quarter, but in the actual data it was down by about 2 points."

In December, Moody's Analytics estimated that state and local governments faced total shortfalls for fiscal 2020 through 2022 of about \$170 billion, after accounting for their own reserves and the federal aid they'd already received. The money from the most recent stimulus package brings the amount needed to stave off spending cuts and tax increases below \$100 billion, White says. "There's still need, but nowhere near a trillion," he says.

Not all Republicans oppose additional aid. State and local government groups stress the need to work with members of Congress from both parties. "We expect to work very closely with them on both sides, to make sure they're aware of the shortfalls cities face and what layoffs are going to mean for the broader economy," says the NLC's Wallace.

Sen. Bill Cassidy of Louisiana has probably been the leading GOP proponent of assisting states and localities. "If we do not provide stability for states, we risk wasting all the money spent to save small businesses," he wrote last May. "These small businesses need basic government services."

At the time, Cassidy was introducing a bill to provide \$500 billion in state and local aid. He was part of the bipartisan group with Manchin that developed the framework for the most recent stimulus, which in their version would have provided \$160 billion in aid.

The total figure may yet be revised downward. Many lawmakers, including Cassidy, will want to put guardrails on the money, to make sure that state and local governments don't use emergency aid to backfill chronic problem areas, such as pensions.

"The substance of state and local aid will be debated, but its prospects are going to depend on the menu of the various other things that are being negotiated," says Scott Pattison, deputy executive director of the Multistate Tax Commission. "With some Republicans supporting aid, they will have other demands that will be pushed."

When state and local governments were left out of the December package, it looked like they had missed the last train out of the station. Now, with Democrats controlling all of Washington, further stimulus is a near-certainty.

With a 50-50 Senate, there's no margin for error. Some money for states and localities will be part of the next package, but it will end up being a lot less than they'd hoped for last year.

"I don't think having a razor-thin Democratic majority in the Senate means we're barreling ahead and doing something like the Heroes Act," Gordon says. "Conditions have changed and a trillion

dollars isn't called for now."

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